

# **CENTER FOR INSTITUTIONAL REFORM AND THE INFORMAL SECTOR**

University of Maryland at College Park

---

Center Office: IRIS Center, 2105 Morrill Hall, College Park, MD 20742  
Telephone (301) 405-3110 • Fax (301) 405-3020

## **COMMUNISM, CONSTITUTIONALISM AND THE TRANSITION TO MARKET-BASED DEMOCRACY**

November, 1993

Stephen L. Elkin, Bartłomiej Kaminski and Cass Sunstein  
Working Paper No. 91

Author: Stephen Elkin, Bartłomiej Kaminski, both University of Maryland, Cass Sunstein, University of Chicago

---

**IRIS Summary                      Working Paper No. 91**  
**Communism, Constitutionalism and the Transition to Market-Based Democracy**

**Stephen Elkin, Bartolomiej Kaminski and Cass Sunstein**

The introduction of a modern constitutional regime in the post-communist countries would assist in overcoming the economic crisis and in preventing political crises. Constitutionalism - the protection of basic rights and the legal order compatible with a market economy - is the best means to consolidate democracy and spur economic development. Without a constitution that protects individual rights, that provides for an independent judiciary, that prevents easy amendment and that secures private property and market transactions, prospects for economic growth in Poland and other post-communist countries will remain gloomy. Without constitutional rights protecting private property and limiting state property rights, government will be under pressure to pursue an ad hoc intervention into the economy. Without freedom of contracts (transfer of property rights) and their judicial enforceability, the costs of economic transactions will impede the division of labor whose development appears to be the only way to economic wealth, as the case of wealthy countries amply demonstrates. Without constitutionalism, any hope of reviving stagnating and often contracting economies of post-communist countries will be crushed. Without the security of citizens' immunity from an arbitrary state, both domestic and international investors will be reluctant to act, since they will be uncertain that their earnings will be truly theirs. Without this security democracy itself is endangered, since people will be deprived of the economic independence that is indispensable to democratic citizenship. And economic hardship creates an environment conducive to nationalism and authoritarianism.

This is the right moment for post-communist countries to enact constitutionally guaranteed political and economic rights protecting their citizens against the whims of the state. International experience shows that constitutionalism is the best means for creating the preconditions for economic prosperity and democracy. A constitutional regime creates a sense of security and reduces the uncertainties of political outcomes. Successive governments are constrained by the provisions of the constitution. A society in which government can at its whim deprive people of their basic rights is a society in which people will never be full citizens. By creating a sense of security and protecting individuals against the state, a constitution supported by an independent judiciary will ease the transition to a market system while simultaneously enhancing democracy.

DRAFT3

**COMMUNISM, CONSTITUTIONALISM AND THE TRANSITION  
TO MARKET-BASED DEMOCRACY**

by

Stephen Elkin (University of Maryland), Bartłomiej Kaminski  
(University of Maryland), and Cass Sunstein (University of  
Chicago)

**Introduction:**

Frustrated with the slow pace of solving formidable problems inherited from the communist past, some doubt whether democratization and marketization can be simultaneously pursued in post-communist societies. According to this view radical economic change is incompatible with democratization. This dilemma so far has not produced a stalemate to a transition in the post-communist world. But the danger is there, because neither full public support for introducing markets nor great indifference to governmental policy can be taken for granted. As groups suffering from economic contraction learn to use the democratic process to protect their interests, there are legitimate fears that the move to provide property based markets may be stalled if not completely derailed.

While we share some of these fears, we do not believe that democratization must impede the transition to a market economy. Indeed the opposite is more nearly the case: economic transformation cannot be accomplished without political consensus building and political restraint. And political consensus and restraint can only come with the right kind of democratic regime, viz., one that is constitutional. Democracy without constitutionalism will lead to both the decline of democracy and the end of any serious hope for economic transformation

and revival.

**The Immediate Need for a Constitutional Regime:**

There are three powerful arguments in favor of a rapid introduction of a democratic constitutional regime in post-communist countries. First, by imposing constraints on both procedures and political purposes, a constitutional regime would greatly reduce both the chances of stalling or reversing the economic transition, and of falling into authoritarianism. If present trends go unchecked, these are probable outcomes. Democracy will remain weak unless supported by a dispersion of economic power in the populace. Although the private sector has in fact rapidly expanded in some countries, economic power is still very much concentrated in the public sector. Moreover, an outburst of diverse and conflicting interests, which have been suppressed by the communists for decades, may exceed the capacity of the fragile political system to handle them. The political systems now in place in post-communist countries allow various groups to press their demands but they make little provision for insuring that the cumulation of such demands does not lead to a weakening of democracy itself, and the unraveling of the institutions needed for a flourishing market economy.

Although any dramatic change in political systems introduces uncertainties for various social groups, the dismantling of communism is more risk prone than any other known transition to democracy. It is already clear that the transition will bring the bitter pill of economic austerity. The transition will dramatically change income distribution, and, groups privileged until now may lose, and, to some

degree, are already losing, their position. Potential and actual victims of the transition are likely to take advantage of the opportunities offered by the democratic process. But, as the experience of countries that have already undergone a transition from authoritarianism also shows, beneficiaries of the change tend to take for granted the opportunities offered by economic change. They are thus unlikely to defend the political order that secures the rules that enable them to flourish.

Constitutional constraints on legislative and executive power can restrain political authorities from simply giving in to all the demands of those distressed by the transition, especially those demands that will halt the transition to a market economy or lead to arbitrary interventions into the society. Because political authorities cannot always rely on the strong support of the beneficiaries of the transition, they need the discipline imposed by constitutional rules in order to resist demands to pursue policies that they--and many others--will later regret.

The second argument in favor of a quick introduction of a constitutional regime is that firm constitutional protection of property rights, combined with an independent judiciary, is necessary to sustained economic growth. Constitutional protection of property rights would encourage international investment. Such devices will also spur domestic investment and initiative. Without such constitutional protection, investors and those interested in starting new business and expanding existing ones, are confronted with the possibility that the state may take their property or abrogate their

contracts. The lack of constitutional protections for property encourages a short-term approach to conducting business: the tendency to strike a deal, make a fast buck, and move on to another area. Projects with a longer time horizon tend to be discarded. Under such conditions substantial economic development is unlikely to occur.

Indeed, as many observers have noted, no country has achieved a high level of economic development without a strong and independent legal order. Without such facilitating instruments provided by the law as exclusive patent rights protecting intellectual property, effective business contract enforcement by the state, a system of extracontractual civil liability and protection of private property, it's unlikely that an affluent society with widely dispersed wealth can arise. The confidence infused by well-defined and protected private property rights and enforceable contracts make people more predisposed to take risks, and to enhance the value of their assets by investing, innovating, and using them productively for the prosperity of the entire country. The welfare loss produced by the absence of a good legal order is enormous.

The third argument in favor of a quick introduction is that constitutionalism can provide the transition to a post-communist society with a badly needed integration of the changes underway in various spheres of social life. These changes have been largely treated as being independent from one another. One transition is from an administered economy to market system. A second is the transition from one party rule to democracy and a competitive party system. A third, often neglected in public debates, is the movement from a

system where the state is subject to soft legal constraints to one guided by the rule of law. In our view, the shaping of change in these three spheres should be conducted in concert. This is what a constitutional framework enables public officials to do. It will make clear, for example, that the rule of law is necessary for a market economy to work, and that open political competition is necessary for the rule of law. A constitutional framework will thus make vivid the inter-connections of the transitions, and reduce the probability that necessary and significant return in any given sphere will be overlooked.

**Varieties of Constitutional Thinking:**

The preceding arguments in favor of a rapid introduction of a constitutional regime call for a new approach to understanding constitutionalism and its corresponding political-economic order. The best way to start developing such an understanding is to emphasize that some forms of constitutional thinking are positively harmful in making the transition work, and in guaranteeing future freedom and prosperity. In particular, the often-observed approach to constitutionalism as the identification of a set of well-intentioned principles and general aspirations is unhelpful. It is, in fact, a legacy of the communist past. "Constitutions," patterned after the 1936 Soviet Constitution, promised everything and facilitated nothing. They contained essentially empty promises of governmental assistance. They imposed duties on citizens, but not on the party-state allegedly representing society and the public interest. They did not deserve to be called constitutions and were in fact not worth the paper on which

they were written. In stark contrast, western constitutions do not specify citizens' duties but specify their right to participate in law-making and in the enforcement of those laws through an independent judiciary.

Another fallacious approach is simply to borrow articles from Western constitutions. They were written in a different institutional environment where private property and a market economy held sway. These conditions were regarded as a natural state of affairs. These constitutions did not have to take into account a communist past, because they had none. They did not have to aim at getting rid of communism's legacies, such as the deeply-rooted disdain for competition and private property, and the view of the party-state as the source of all solutions. Hence, the drafting of a constitution for a country like Poland calls for a different approach. In brief, a constitutional regime for a country in transition should provide guarantees for **optimal use of the potential inherent in competitive markets** in order to stimulate economic growth. Older constitutions did not have to be explicit about such matters; indeed, as written many of them allow nationalization of productive assets as long as fair compensation is paid.

A properly designed constitution and the political-economic order it helps to foster will help attain two fundamental goals of the transition to a market-based democracy: the establishment of a civil society and of a market economy. No matter whether the ultimate goal is to create the minimum state characteristic of classical liberalism or a social-democratic welfare state, the point of departure must be



such a depoliticized social and economic sphere. All desirable combinations of the state and the market require autonomy both for the economic sphere and for civil society. And these cannot be attained without a self-limiting political regime, which is precisely what constitutionalism aims to insure.

**Features of a Constitutional Regime:**

What features should a constitutional regime for a post-communist society have, and what provisions should the constitution contain? Any list of provisions of an adequate constitutional regime would include the following: (1) guarantees of individual political and economic rights; (2) amendment of constitutional rights and constitutional provisions only by larger than simple majority vote; (3) constitutional rights able to be invoked by ordinary citizens in independent courts authorized to bar governmental action; (4) an independent judiciary, including arrangements for preventing the destruction of the courts' independence; (5) a ban on the **state's direct management** of state-owned enterprises. This is the set of minimal conditions that would best serve the development of democracy and a market economy. The ranking does not reflect their relative importance. They are of equal standing: the removal of any one provision would drastically weaken the prospects and realization of a desirable post-communist regime. In addition, two other provisions could be inserted concerning (6) the independence of the central bank and of the (7) mass media from the government.

The constitution should protect basic individual rights (provision 1). In protecting these rights, and thus constraining

arbitrary action by the state, the rule of law will be fostered. The most prominent among these are freedom of speech, assembly and press, freedom of religion, the right to private property, and freedom of contract. The latter two emphasize the rights people have over assets that are directly relevant to the functioning of a market economy. Without constitutional protection of these economic rights, the full potential of the market mechanism cannot be tapped. An independent constitutional tribunal, and courts open to complaints by individuals, local governments and private organizations, will enforce these constraints on government (provisions 3 and 4).

In general, constitutional principles should be worded in a way that independent courts can unambiguously decide whether the Constitution is being observed or not. For instance, an article making the government responsible for a decent standard of living -- i.e. a "right to a decent living standard" -- should not be included, because in most cases courts will not have any non-arbitrary grounds for deciding whether the provision is being met. Such issues, and those related to the "welfare state" generally, should largely be left to the political process. Without going into detail, we think, it would be worthwhile to explore provisions that would constrain the proclivity of a post-communist state to excessive paternalism.

Insuring the independence of courts (provision 4) is crucial but fraught with difficulty. Any judicial review of state action aimed at seeing that the state complies with its own laws and does not transgress the Constitution is likely to encounter resistance from state officials. When a government loses a battle in the courts, it is

bound to be an irritant to the prime minister, the president and to governing party members. Similarly, substantial conflict is bound to affect the transition to a post-communist regime and to be an on-going feature of society. When courts, for example, uphold the rights of an employer to lay off workers, it will directly affect a substantial number of people. In their perception, the courts will be the source of their troubles. In these circumstances, ambitious and unscrupulous politicians will seek popularity through encouraging aggrieved citizens in their attacks on the independence of courts. Provisions in the constitution must be made to prevent such attacks from undermining the integrity of the constitutional regime and of the document on which it rests.

There are several ways to achieve this. The legislature may be constrained by imposing a super-majority requirement (provision 2). The Constitution might be able to be amended only by, for instance, a two thirds majority vote. Any proclivity to toy with the Constitution could be further limited by giving a veto power to the President. If an amendment is vetoed, for example, the amendment would be shelved for at least a year. The tendency to use a Constitution as a tool of everyday governance can also be constrained by distributing power among major branches of the government in such a way that attacks by legislators on the courts can be effectively resisted by an alliance of the judiciary and the President.

The survival of an independent judiciary also requires the development of a constitutional consciousness among both the electorate and elected officials. The essence of constitutionalist

thinking is a widespread conviction that a democratically elected government has to be restricted in its purposes and activities. Politicians, it needs to be understood, are only human, and they can commit errors and fall victim to ambitions which may impose enormous social costs.

Constitutional consciousness can take root through education in schools and the experience of participation in local governments. The case for constitutionalism is pervasive and straightforward. By referring to the not so remote history of either Stalinism or Nazi Germany, the enormous damage and misery inflicted by governments unconstrained by democratic constitutions can easily be shown. Similarly, it is not difficult to realize the advantages of a constitutional regime when a local official has to deal with cases of arbitrariness of state administration. When constitutional consciousness takes hold, politicians who reject constitutionalism and an independent judiciary are more likely to be rejected by voters.

Provision 5, which is absent in western constitutions, imposes limits on the ways government can intervene in the economy. Under communism, the state owned almost all capital assets, and prices bore no relation to scarcities and production costs. Although some post-communist countries have gone a long way in decontrolling prices, future governments may be tempted to re-introduce administrative price controls. Even assuming a strong commitment to privatize SOEs (state-owned enterprises), a sizable portion of them will remain state-owned for the next decade or so. In order to keep up the momentum in the transformation of the economic system, constitutional provisions

should bar government's **direct** intervention in SOEs: the only kind of intervention allowed would be through influencing market forces. SOEs would then be immune from direct political pressure that are usually harmful to their economic efficiency. In addition, removing SOEs from the political process would make incomes of their employees subject to market forces rather than bureaucratic clout. Since incomes would be independent of election results, democracy would be consolidated and stabilized. This limitation on state property rights is compatible with the so-called corporatization of SOEs currently underway in Central Europe. Public utilities may, however, call for special treatment.

While these five provisions constitute the core of a viable constitutional regime for a post-communist country, two additional provisions would facilitate the transition. The provision concerning the independence of the central bank (provision 6) would enhance the autonomy of SOEs. International experience clearly demonstrates the linkage between inflation and the autonomy of central banks: the more independent the central bank, the lower the rate of inflation. The independence of the central bank would mean a hardening of legal and budgetary constraints, which in turn would help solve the Central European paradox of inflation accompanied by central government surpluses.

The last provision calls for the independence of mass media, especially of television, which still remains under government tutelage. The independence of television should be constitutionally guaranteed. One possible way is to establish an independent board.

Another way would be to open TV channels to private companies. Whatever solution is adopted, television should be re-organized so that it is independent from government.

**Conclusion:**

The introduction of a modern constitutional regime would assist post-communist countries in overcoming economic crisis and preventing political crises. Constitutionalism--the protection of basic rights and the legal order compatible with a market economy--is the best means to consolidate democracy and spur economic development. Without a constitution that protects individual rights, that provides for an independent judiciary, that prevents easy amendment and that secures private property and market transactions, prospects for economic growth in Poland and other post-communist countries will remain gloomy. Without constitutional rights protecting private property and limiting state property rights, government will be under pressure to pursue ad hoc intervention into the economy. Without freedom of contracts (transfer of property rights) and their judicial enforceability, the costs of economic transactions will impede the division of labor--and its development is the only way to economic wealth, as the case of wealthy countries amply demonstrates. Without constitutionalism, any hope of reviving stagnating, and often contracting, economies of post-communist countries would be crushed. Without the security of citizen's immunity from an arbitrary state, investors--both domestic and international--will be reluctant to act, since they will be uncertain that their earnings will be truly theirs. Without this security democracy itself is endangered, since people

will be deprived of the economic independence that is indispensable to democratic citizenship. And economic hardship creates an environment conducive to nationalism and authoritarianism.

This is the right moment in post-communist countries for enacting constitutionally guaranteed political and economic rights, and for protecting citizens against the whims of the state. International experience shows that constitutionalism is the best means for creating the pre-conditions for economic prosperity and democracy. A constitutional regime creates a sense of security and reduces the uncertainties of political outcomes. Successive governments are constrained by the provisions of the constitution. A society in which government can at its whim deprive people of their basic rights is a society in which people will never be full citizens. By creating a sense of security and protecting individuals against the state, a constitution supported by an independent judiciary will ease the transition to a market system while simultaneously enhancing democracy.